DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY

Docket No. 00-22

State of Michigan's
Memorandum of Law Objecting to OCC Preemption
of the Michigan Motor Vehicle Sales Finance Act

Request for preemption.

The Office of the Comptroller of the Currency (hereafter "OCC") has invited comments relative to the interpretation and applicability of a Michigan consumer protection act entitled as the Michigan Motor Vehicle Sales Finance Act (hereafter "MVSFA"), MCL 492.101 *et seq*; MSA 23.628(1) *et seq*. The OCC's request for comments reflects that inquiry has been made for a determination that the National Bank Act preempts MVSFA. The inquiry is in response to a Declaratory Ruling issued on January 1, 2000, by the Commissioner of the former Michigan Financial Institutions Bureau (now Office of Financial and Insurance Services, Division of Financial Institutions), which held that a specific loan program proposed by National City Bank did not constitute a "direct loan program" but rather described installment sale contracts governed by the MVSFA. The Declaratory Ruling is incorporated by reference herein, and attached as Exhibit 1.

Position of the Michigan Division of Financial Institutions.

The Michigan Division of Financial Institutions opposes any effort to find that the MVSFA is in any way preempted by the National Bank Act.

The Issue.

The real issue in this matter is simple: Is the loan transaction proposed by National City Bank a direct loan or an installment sale contract as those terms are defined in Michigan law?

If the transaction is a direct loan, it is **not** subject to the MVSFA. If, however, the transaction is an installment sales contract, it **is** subject to the MVSFA. On January 1, 2000, the Commissioner issued a well-reasoned Declaratory Ruling addressing this matter in great detail. The Declaratory Ruling concluded that the proposed transaction by National City Bank constituted an installment sale contract subject to MVSFA.

Background to the Michigan Declaratory Ruling.

In July 1999, counsel for National City Bank, a national bank headquartered in Ohio and conducting business in Michigan, requested a declaratory ruling from the state financial institutions commissioner, to address the applicability of the MVSFA to a proposed specific loan program described in the request. A copy of the request is attached as Exhibit 2.

Based on the state of facts presented by National City Bank, the bank would contract with Michigan motor vehicle dealers to establish a "limited agent" relationship. The motor vehicle dealers would take applications for motor vehicle loans, prepare loan documentation, and close loans by obtaining buyer's signature on required documents. "The dealers would be given no authority to bind National City regarding the terms of loans, except that the dealer could, within a range established by National City, negotiate a higher interest rate." (Exhibit 2, p 2).

National City Bank would prescribe the terms of the loan, including the minimum interest rate. The motor vehicle dealer, then, could negotiate an interest rate with the buyer that was higher than National City Bank's minimum interest rate. The difference between the minimum interest rate and the negotiated interest rate, called the yield-spread differential, plus a

commission paid the dealer by the bank, would comprise the compensation to the dealer by National City Bank for the dealer's activities. National City Bank characterized these loans as "direct loans," which, if true, would not be governed by the MVSFA.

Further, National City Bank claimed it would have no right of recourse against the dealer other than to sue the dealer for breach of its agency relationship.

The Michigan Declaratory Ruling.

On January 1, 2000, the Commissioner issued his Declaratory Ruling. The Commissioner concluded that the loans described by National City Bank in its specific state of facts were not direct loans. Rather, they were installment sale contracts and were subject to the provisions of the MVSFA. The Declaratory Ruling examined the proposed loan program in detail and concluded that the proposed loan program is functionally equivalent to a typical bank-dealer relationship commonly referred to as "dealer reserve," "dealer participation," or "dealer agency agreement." These contracts specify the rights and duties of the parties and establish a method of calculating fees paid by the lender to the dealer. The Declaratory Ruling provides a comprehensive analysis of these programs. A detailed comparison of the proposed program of National City Bank to a typical installment sale contract and a typical direct loan is set forth in Exhibit "A" to the Declaratory Ruling, and is incorporated herein by reference.

National City Bank, however, mischaracterized as "direct loans" transactions resulting from the proposed loan program. They are not direct loans. National City Bank's proposed loan program is functionally equivalent to installment sale contracts, which are transactions subject to the MVSFA. As expressed in the Declaratory Ruling:

> In the typical installment sale contract transaction, the dealer assigns its interests in an installment sale contract to the predetermined lender for a fee (yield-spread differential). In effect, the lender compensates the dealer for participating in the lender's contract-making process. In the National City "direct lending program," the dealer is compensated in a similar fashion for its involvement in National City's transaction. For each installment sale processed by the dealer on National City's behalf, National City pays the dealer a fee (yield-spread differential). This fee is a payment that in no significant aspect differs from the fee received by the dealer in the assignment of an installment sale contract. In fact, National City's "Auto Rates" sheet (yield-spread pricing schedule) does not differ from those customarily used in the installment sale market. Therefore, the outcome of assigning an installment sale contract - dealer receipt of a payment from the lender of assignment - is effectively no different from the dealer receiving a "dealer commission fee" from National City. Thus, the true relationship between National City and the dealer is one based on an installment sale transaction, underpinned by an elaborate fiduciary relationship created by the preexisting "Dealer Documentation Agreement." It is a preexisting contractually based relationship that allows Dealers to selectively induce consumers to finance their installment purchases through the National City. It is a transaction that is much more complex and comprised of a great many more duties and obligations than any direct loan program." (Exhibit 1, p 4, 5).

The law obligates the OCC to look beyond "form" to the true "substance" of the transaction.

As addressed at length in the Declaratory Ruling, any analysis of the purported "direct lending program" requires looking beyond "form" to "substance". In seeking a declaratory ruling, the national bank relied upon *Barnes v Michigan National Bank*, 159 Mich App 433; 407 NW2d 23 (1987). The Michigan Court of Appeals opinion in *Barnes*, however, provided the analysis that must be conducted in deciding whether a particular transaction is a "direct loan" and not subject to the Act, or in reality, an "installment sale contract" subject to the Act. The *Barnes* case involved a financing agreement between the purchaser of a motor vehicle and a national bank. The court found in this case that the agreement ". . . was a direct loan from the bank to the consumer plaintiffs." The court explained that:

> The overriding consideration in this case is the *true relationship between the bank and the plaintiffs*, and the *lack of any relationship between the dealer and the*

> *bank*. The crux of the transaction was that of a personal loan by the bank to the plaintiffs, not dealer- or bank-induced financing of the sale of the motor vehicle. As the trial court correctly recognized, even if the bank was found to be within the scope of the MVSFA and subject to the defenses plaintiffs had against the dealer, the bank is without recourse against the dealer. Where, as here, the bank is an unrelated third party which has made a separate transaction with plaintiffs to extend them credit, we cannot conclude that the Legislature intended the bank to be left "holding the empty bag." 150 Mich App at 439. (Emphasis supplied.)

A proper analysis requires the OCC to look through the transaction's label and determine to what extent the transaction is made directly between the bank and the consumer. To this end, the "true relationship between the lender and the borrower must be weighed against the relationship between the dealer and the lender". If there is a complete lack of any relationship between the dealer and the lender, then the transaction may be found to be a true "direct loan" and exempt from the Act. However, if any relationship exists between the dealer and the lender, then a weighing of the lender/borrower and dealer/lender relationships must be undertaken. The greater the relationship between the dealer and lender in the transaction, the greater the likelihood the transaction is subject to the MVSFA.

Lenders and their dealer agents can not evade or circumvent the MVSFA by labeling installment sale contracts as direct loans. Where the substance of a transaction is clearly within the purview of the MVSFA, a consumer must be able to rely on the important consumer protection provisions of the MVSFA, set forth in detail hereafter. If transactions that in substance are "installment sale contracts" are not made subject to the MVSFA, the public interest of consumer protection embodied in the Michigan law is defeated. No public interest is advanced by allowing an entity to alter the form of a transaction, but not its substance, to evade or circumvent the MVSFA. Only a true direct loan--a loan lacking any material relationship

between the dealer and the lender, and where the crux of the transaction is that of a personal loan by the lender to the borrower, (not dealer- or lender-induced financing of the sale of the motor vehicle)--can be allowed to escape the consumer protection provisions of the Act. To do otherwise is to exalt the form of the transaction over its substance and to acquiesce to the lender's determination that its dealings with Michigan consumers are not subject to the MVSFA.

The "substance over form" test is a transactional examination device used to ". . . look through a transaction so as to avoid the betrayal of justice . . ." *People v Lee*, 447 Mich 552, 561 (1994). The test is to simply ". . . look squarely at the real nature of the transaction, thus avoiding . . . the contrivances of form, or the paper tigers of the crafty." *Wilcox v Moore,* 354 Mich 499, 504 (1958). The label given to the agreement by the parties does not control an examination of the agreement's provisions. "In construing the contract, all circumstances accompanying the transaction must be taken into consideration. It is to be given the meaning that would be attached to it by a reasonably intelligent person, knowing all the circumstances prior to and contemporaneous with the making of the integration." *Seaboard Surety Co. v Bachinger*, 313 Mich 174, 178, 179, 180 (1945) (cited with approval in *Kimmel v Hammond*, 352 Mich 625, 630 (1958)). A substance over form analysis ". . . will look into all of the circumstances under which it was made, in order to determine the proper meaning of the transaction." *Foster v Ypsilanti Savings Bank*, 299 Mich 258, 268-269 (1941) (quoting *Hess v Haas*, 230 Mich 646, 652 (1925)).

The label given to the agreement by itself is not determinative of the agreement's provisions and "all circumstances accompanying the transaction must be taken into consideration. This is important not only for uniform administration of the MVSFA, but to further Michigan's public policy of encouraging the sale of retail goods on credit while placing strict usury limits on outright loans of money. The technical distinctions between credit sales (installment sale contracts) and loans of money must be maintained. Where the substance of a loan, labeled to be

direct or otherwise, does not differ in any significant aspect from a transaction subject to the MVSFA, the transaction will be found to be an installment sale contract subject to the MVSFA. Review of the proposed transaction and potential relationship between National City and installment sellers licensed under the MVSFA reinforces the conclusion that the National City "direct lending program" does not differ materially from a transaction subject to the MVSFA. In order to participate in the "direct lending program," a dealer must enter into a "Dealer Documentation Agreement" with National City. This agreement in elaborate detail outlines the rights and duties of National City and the dealer. As was pointed out in the request for declaratory ruling, the MVSFA "was enacted to limit the rate and terms under which a motor vehicle dealer could sell an automobile. . ." In the National City transaction, the dealer is permitted to increase the interest rate term by as much as six percentage points. Arguably, if the National City transaction was found not to be subject to the MVSFA, the dealer and National City could agree to allow the dealer to set all of the terms of the installment sale regardless of the MVSFA. Clearly, this is not what was intended by the Michigan legislature, and perhaps the very reason section 2(9) was enacted to broadly define "installment sale contract" to include "any other form of contract that has a similar purpose or effect."

By analogy, federal case law, especially in the area of branching, has recognized the authority and responsibility of the OCC to look through transactions to see that a plan is nothing more than a subterfuge to evade state law. *Marian National Bank of Marian v Van Buren Bank*, 418 F 2d 121 (CA 7, 1969). In maintaining competitive equality between national and state banking systems, for example, one must look to substance and not form. *Jackson v First National Bank of Gainesville*, 430 F2d 1200 (CA 5, 1970). If simultaneous applications are, in reality, a scheme or subterfuge to circumvent or evade state law, the Comptroller's plain duty is to deny the applications--not facilitate them. *First National Bank of South Haven v Camp*, 333 F Supp 682 (ND Miss 1971), *aff'd* 467 F2d 944 (CA 5, 1971); *Bank of Dearborn v Saxon*, 244 F

Supp 394 (ED Mich 1965), *aff'd Bank of Dearborn v Manufacturers Nat'l Bank of Detroit*, 377 F2d 496 (CA 6, 1967). In *American Bank & Trust Co v Saxon and Dart Nat'l Bk of Mason*, 373 F2d 283 (CA 6, 1967), the Sixth Circuit took a dim view of the Comptroller's efforts to evade Michigan law holding that the Comptroller was arbitrary, capricious and clearly erroneous and not in accordance with law.

Indeed, very recently the 6th Circuit Court of Appeals once again recognized the OCC's duty to look through "form" to "substance," as it must now do in this case. In *McQueen v Williams*, 177 F3d 523 (CA 6, 1999), the court had occasion to reverse the OCC's approval of a series of transactions in which KeyCorp, a bank holding company, sought to create a major regional banking network and to engage in interstate banking in the Michigan-Indiana-Ohio tristate area. There, the court recognized that KeyCorp's plan to accomplish its goals, blindly blessed by the OCC, was in fact done through an illegal and circuitous route. Specifically, in *McQueen* the Commissioner of the Michigan Financial Institutions Bureau challenged the OCC's approval of a newly converted national bank's designation of a branch in Bronson, Michigan as the national bank's "main office". In rejecting the "main office" designation as a sham and a fiction in violation of 12 USC 30(b), and in finding an illegal relocation instead, the court held that the OCC had a duty to consider the conversion scheme as a whole and to consider the bona fides of the transactions. The court said:

> Looking to the substance, rather than the form, of the bank's application in the instant case, it is apparent that Society -Michigan actually sought to accomplish a relocation of its "principal office" upon conversion. . ." *McQueen, supra*, 532.
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> . . . we find that the "designation" of the Bronson branch as the converted bank's "main office" was a fiction and sham under the circumstances of this case. In looking to the substance of this designation, it is clear that Society-N.A. never intended to establish a "main office" at that location. *McQueen, supra*, 533.

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A totality of the circumstances is relevant to an inquiry into whether the establishment of a "main office" is *bona fide* or whether it is a sham. *McQueen, supra*, 534. (Emphasis added.)

Just as in *McQueen*, the OCC has a responsibility in this matter to look through form to substance and recognize that the indicia of this so-called "direct lending program" is effectively an installment sale contract subject to MVSFA, as carefully expressed in the Commissioner's Declaratory Ruling.

Michigan's Motor Vehicle Sales Finance Act is a State Consumer Protection statute which is not preempted by Federal law.

Michigan's MVSFA is not a banking law. It is a consumer protection statute which is not preempted by Federal banking law. The Legislative history makes unequivocally clear that the MVSFA was intended to protect Michigan consumers entering into installment sale contracts for the purchase of motor vehicles. The preamble of the MVSFA reads as follows:

AN ACT defining and regulating certain installment sales of motor vehicles; prescribing the conditions under which such sales may be made and regulating the financing thereof; regulating and licensing persons engaged in the business of making or financing such sales; prescribing the form, contents and effect of instruments used in connection with such sales and the financing thereof; prescribing certain rights and obligations of buyers, sellers, persons financing such sales and others; limiting charges in connection with such instruments and fixing maximum interest rates for delinquencies, extensions and loans; regulating insurance in connection with such sales; regulating repossessions, redemptions, resales and deficiency judgments and the rights of parties with respect thereto; authorizing extensions, loans and forbearances related to such sales; authorizing investigations and examinations of persons engaged in the business of making or financing such sales; transferring certain powers and duties with respect to finance companies to the commissioner of the financial institutions bureau; and prescribing penalties. (Emphasis added.)

The MVSFA protects Michigan consumers by requiring that they receive an exact copy of the installment sale contract, with full disclosure of terms and finance charges. In addition, the MVSFA limits documentary preparation fees to $40.00. Also, the MVSFA regulates "trade-in"

practices, and insurance premiums. The MVSFA prohibits accelaration clauses in contracts, and covers repossession practices. Furthermore, the MVSFA prohibits waivers of certain legal rights, and provides purchasers with holder in due course protections. Accordingly, the MVSFA provides significant consumer protections for the citizens of Michigan.

It is well recognized in the Riegle-Neal Interstate Banking and Branching Efficiency Act that any branch of an out-of-state national bank is subject to STATE LAW with respect to intra-state branching, fair lending, community reinvestment, and CONSUMER PROTECTION as if the national bank were a branch of a host state bank. The Gramm-Leach-Bliley Act also recognizes that state consumer protection laws govern.

Federal preemption of a state licensure act will not be found where the state licensure statute was created to protect the public and the license requirement relates directly to the individual licensee and not federal property, and Congress has not exempted the individual licensee from complying with the state statute. The MVSFA fits all these criteria, and should not be preempted by the OCC.

The National Bank Act does not preempt state regulation of motor vehicle financing.

The National Bank Act was enacted to equalize the standing of national banks with their state-chartered competitors, and to prevent state legislatures from discriminating against national banks. See *Marquette Nat'l Bank v First of Omaha Serv Corp*, 439 US 299, 314; 99 S Ct 540; 58 L Ed2d 534 (1978). The National Bank Act does not contain an express statement that Congress intended to preempt state law in its entirety. In the absence of express statutory preemption, conflict preemption may be implied where it is impossible to comply with both state and federal requirements, or where state law stands as an obstacle to achieving the intent of Congress. See *Freightliner Corp v Myrick*, 514 US 280, 287; 115 S Ct 1483; 131 L Ed2d 385 (1995). As with express preemption , conflict preemption will not be found unless it is the clear intent and purpose of Congress. *CSX Transportation, Inc v Easterwood*, 507 US 658, 664; 113 S Ct 1732;

123 L Ed2d 387 (1993).

Preemption of state law can be found only when "Congress intends that federal law occupy a given field," or when state law "actually conflicts with federal law, that is, when compliance with both state and federal law is impossible. . . or when the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *California v ARC America Corp*, 490 US 93, 100-101; 109 S Ct 1661; 104 L Ed2d 86 (1989). None of these prerequisites exist here.

Banking is not an area in which Congress has evidenced an intent to occupy the entire field to the exclusion of the states, and thus, state legislatures may legislate in all areas not expressly or impliedly preempted by federal legislation. *Video Trax, Inc v Nationsbank, N.A.*, 35 F Supp 2d 1041, 1048 (SD Fla 1999). In fact, federal courts have recognized that "national banks have traditionally been governed in their daily course of business far more by the laws of the State than of the Nation. All [of] their contracts are governed and construed by State laws." *National Bank v Commonwealth*, 76 US (9 Wall) 353, 362; 19 L Ed 701 (1869). Except for a few instances in which Congress has explicitly preempted state regulation of national banks, "regulation of banking has been one of dual control since the passage of the first National Bank Act in 1863." *National State Bank v Long*, 630 F2d 981, 985 (3rd Cir 1980). Thus, the rule is that state laws apply, "unless those laws infringe the national banking laws or impose undue burden on the performance of the banks' functions." See *Anderson Nat'l Bank v Luckett*, 321 US 233, 248; 64 S Ct 599; 88 L Ed 692 (1944).

Since Congress has not displaced all state legislation affecting national banks, state law will be preempted only "to the extent that it actually conflicts with federal law." *Silkwood v Kerr-McGee Corp*, 464 US 238, 248; 104 S Ct 615; 78 L Ed2d 443 (1984). Courts must not

lightly infer preemption, and it is the burden of the party claiming Congress intended to preempt state law to prove it. The authority to displace a sovereign state's law is "an extraordinary power. . . that we must assume Congress does not exercise lightly." *Gregory v Ashcroft*, 501 US 452, 460; 111 S Ct 2395; 115 L Ed2d 410 (1991).

The preemption by the OCC of a state's non-banking law as that law relates to non-banks would be totally unwarranted by the facts presented here. To preserve a state's right to regulate the non-banking activities of non-banks is fundamental to our concept of federalism and of ordered liberty.

OCC may not preempt non-banking regulatory activities of states.

If the OCC determined the MVSFA was preempted by the National Bank Act, the result would be absurd. The result would be the preemption of a state law that licenses and regulates the non-banking activities of non-banks. The result would also be the preemption of a state's criminal sanction against a non-banking regulated entity. See MCL 492.137; MSA 23.628(37). Finally, the result would be the preemption of a state's consumer protection laws. The OCC is without authority to determine federal law preempts a state law that regulates the non-banking activities of non-banks. In addition, the OCC lacks authority to preempt a state's criminal law.

The fact that the MVSFA might contain provisions that do not conveniently accommodate a contemplated business practice of National City Bank is not relevant. National City Bank is not precluded from making true direct loans with its customers for the purchase of motor vehicles. And, neither the MVSFA nor the Commissioner's ruling places National City Bank in any disadvantageous competitive position. In fact, under the MVSFA and the declaratory ruling, National City Bank competes equally with all lenders in this arena. If the

OCC were to determine the MVSFA is preempted, National City Bank might move to a position of significant competitive advantage over other lenders, not to a position of competitive equality.

The Declaratory Ruling is not a directive to national banks.

The Declaratory Ruling is not a directive to national banks, as the MVSFA does not seek to regulate national banks. Rather, the MVSFA licenses and regulates motor vehicle installment sellers and provides a framework under which motor vehicle installment sellers may conduct their business. The MVSFA does not restrict in any way a national bank from directly financing loans for motor vehicles with its customers.

MVSFA does not impair the ability of national banks to conduct business with their customers.

The two requests for preemption determination argue that the MVSFA and the declaratory ruling impair their ability to conduct business with their customers. Persons that have no relationship with National City Bank, and who otherwise seek to purchase a car from a dealer, are not customers of the bank.

The fact that National City Bank might wish to finance the purchase of motor vehicles sold through dealerships does not, by itself, make prospective purchasers of motor vehicles customers of the bank. The purchaser is not a customer of the bank merely because the bank wants the purchaser to be a customer. For a loan to be a direct loan there needs to be a substantive relationship between the purchaser and the bank, and no substantive relationship between the bank and the dealer. (*Barnes* at 439)

The requests for preemption misconstrue the Michigan Declaratory Ruling.

In September 2000, two national banks requested the OCC to preempt the MVSFA not only as it might apply to national banks, but also as it applies to motor vehicle dealers.

The requests to the OCC for a preemption determination mischaracterize the Commissioner's declaratory ruling. The OCC's preemption determination must focus on the state of facts in the request for the declaratory ruling and the Commissioner's ruling itself.

With regard to the request to the OCC dated September 21, 2000, the author throughout his correspondence refers to the loan program proposed by National City Bank as "direct loans." They are not direct loans, however, for the reasons stated in the Declaratory Ruling.

The matrix attached to the Declaratory Ruling compares the typical direct loan, the typical installment sale contract, and the proposed loan program by National City Bank. The proposal is functionally equivalent to that of a typical installment sale contract.

The September 21, 2000, letter, at page 2, also misstates the issue for determination by the OCC. The author states:

> The preemption issue which this poses for determination by the OCC is whether a national bank can be prohibited--by state regulation of the bank's third-party agents--from exercising its lending authority under [section] 24 (seventh) and [section] 85 to originate loans directly to the bank's customers through third-party agents.

This is not the issue before the Comptroller. The Declaratory Ruling did not interpret the MVSFA to prohibit direct loans between banks and the bank's customers; and the OCC cannot

take as a given that the loan program proposed by National City Bank is a direct loan program. It is not. The OCC must look at the specifics of the proposed loan program.

The issue was clearly stated in the Declaratory Ruling:

> . . . is the National City transaction a direct loan and not within the meaning of the Act's definition of "installment sale contract," or is the transaction an "installment sale contract" subject to the Act?

The Declaratory Ruling does not prohibit transactions involving direct loans from banks to motor vehicle buyers.

Next, on page 2 of the September 21, 2000, letter, the author states:

> As practical matter, it is not possible for a direct loan from a national bank to its customer to comply with the requirements of the MVSFA.

This is also a mischaracterization. True direct loans are exempt from regulation under the MVSFA. A loan is not a direct loan merely because a bank calls it one. One must look to the substance of the loan transaction to determine its character. Any bank customer may contact his or her bank, negotiate a loan, obtain a check for the loan proceeds, and use the loan proceeds to purchase a vehicle. And any bank may initiate such a transaction with its customers. Again, direct loans are not regulated by the MVSFA.

On page 4 of the September 12, 2000, letter, the author misstates the intent of the FIB:

> Actually it is the FIB that is artificially labeling direct loans as installment sale contracts for the purpose of bringing direct loans within the scope of the MVSFA.

The Commissioner did not mislabel direct loans as installment sale contracts. The transactions proposed by National City Bank simply are not direct loans under Michigan law

based on the bank's own description of the proposed transactions.

It is fundamental to the review of the declaratory ruling to analyze and understand the request for the ruling. The loan program as proposed by National City Bank was not a direct loan program. This loan program has essentially all the elements of an installment sale contract and virtually none of the elements of a true direct loan. (See matrix attached to Exhibit 1.)

The dealer is not an agent of the bank for the purpose of making direct loans. Rather, the dealer is an agent of the bank for the purpose of collecting information and forwarding that information to the bank. By the bank's own admission, the dealer would have no authority to bind the bank regarding the terms of the loans. (Exhibit 2, p 2.)

Finally, on page 6 of the September 21, 2000, letter the author misstates the declaratory ruling itself:

> . . . the practical result of the FIB's position in the Declaratory Ruling is that the MVSFA completely prohibits national banks from making direct loans through dealership locations[.]

The MVSFA does not prohibit national banks, or any other lenders, from making direct loans at dealerships. Instead, the Commissioner ruled that under the MVSFA the specific loan program proposed by National City Bank was not a direct loan program.

The author of the request for preemption determination dated September 14, 2000, also mischaracterized the declaratory ruling. As stated above, the loans proposed by National City Bank are not direct loans; they are loans that are included in the definition of installment sale contracts as defined in the MVSFA.

The Commissioner ruled that loans contemplated by the specific state of facts proposed by National City Bank constitute installment sale contracts under the MVSFA. The author of the requests for preemption determination would have one believe the outcome of the Commissioner's ruling would apply to all loans made directly by national banks to their customers. In fact, the MVSFA does not apply to any true direct loans made by any lender.

The loans proposed by National City Bank are simply not direct loans.

Mischaracterization carried over in OCC's Notice (Docket No. 00-22).

On October 16, 2000, the OCC issued its Notice of Request for Preemption Determination in this matter (Docket No. 00-22).

The mischaracterization by the two banks of the Commissioner's declaratory ruling is carried into the Notice and Request for Preemption Determination. The conclusion stated in the Notice that a national bank cannot originate motor vehicle loans through a dealer is inaccurate. The proper conclusion of the Declaratory Ruling is that a credit program that substantively meets the test of a direct loan is exempt from coverage by the MVSFA, while a credit program, the transactions of which meet the definition of installment sale contract, is subject to the MVSFA. The proposed loan program of National City Bank is substantively an "installment sale contract."

The Notice of Request for Preemption Determination characterizes the MVSFA and the Commissioner's Ruling as a statute and ruling that improperly restrict the activities of national banks. To the contrary, neither the MVSFA nor the declaratory ruling prescribes activities in which national banks may or may not partake. The MVSFA regulates motor vehicle dealers and

their installment sale financing activities.

The Loan Transaction Proposed by Bank is *ultra vires* and impermissible under Michigan law.

The MVSFA has governed installment sales of motor vehicles in Michigan for a half century. The MVSFA was enacted by the Legislature to benefit and protect retail installment buyers of motor vehicles by regulating installment sales, including interest, required contract disclosures, insurance premiums and other costs, as well as a number of consumer protections, such as a prohibition on acceleration clauses. There are generally three parties to every installment sale transaction: the "installment seller" (the dealer), the "installment buyer" (the consumer), and the "sales finance company" (which includes banks, thrifts, credit unions and others), as each is defined in section 2 of the MVSFA, MCL 492.102; MSA 23.628(2).

The Commissioner of the Office of Financial and Insurance Services is statutorily charged with the administration and enforcement of the MVSFA. Under the MVSFA, both installment sellers and sales finance companies must obtain a license to engage in the installment sales of motor vehicles. The MVSFA, § 3, states in pertinent part:

> . . . a person shall not engage in this state as a principal, employee, agent, or broker in either of the following unless that person is licensed as provided in this act:
> (a) The business of an installment seller of motor vehicles under installment sales contracts.
> (b) The business of a sales finance company.
>
> MCL 492.103; MSA 23.628(3).

"Installment seller" and "sales finance company" are defined in MVSFA, § 2, in pertinent part:

4. "Installment seller" or "seller" means a person engaged in the business of selling, offering for sale, hiring, or leasing motor vehicles under installment sales contracts or a legal successor in interest to that person. As used in this subdivision, "business" does not include an isolated sale.

* * *

6. “Sales finance company” means a person engaged as principal, agent, or broker in the business of financing or soliciting the financing of installment sale contracts made between other parties, and includes the business of acquiring, investing in, or lending money or credit on the security of the retail seller's interest in such contracts whether by discount, purchase, or assignment of those contracts, or otherwise. The term does not include a person, financial institution, or sales finance company that takes assignments of, or an interest in, an aggregation of installment sale contracts only as security for bona fide commercial loans under which, in the absence of default or other bona fide breach of the loan contract, ownership of the contracts remains vested in the assignor and collection of payments on the contracts is made by the assignor, nor a person who purchases installment sale contracts from a sales finance company or a financial institution. The term includes a person, whether or not licensed under this act, who as a seller finances installment sale contracts for other sellers or sales finance companies. The term includes a financial institution.

Key to this licensure requirement is the meaning of the phrase "installment sale contract."

Section 2 of the MVSFA states, in pertinent part, that:

9. “Installment sale contract” or “contract” means a contract for the retail sale of a motor vehicle, or which has a similar purpose or effect, under which part or all of the price is payable in 2 or more scheduled payments subsequent to the making of the contract, or as to which the obligor undertakes to make 2 or more scheduled payments or deposits that can be used to pay part or all of the purchase price, whether or not the seller has retained a security interest in the motor vehicle or has taken collateral security for the buyer's obligation, and includes a loan, mortgage, conditional sale contract, purchase-money chattel mortgage, hire-purchase agreement, or contract for the bailment or leasing of a motor vehicle under which the hire-purchaser, the bailee, or the lessee contracts to pay as compensation a sum substantially equivalent to or in excess of the value of the motor vehicle, **and any other form of contract that has a similar purpose or effect**. The terms do not include a sale or contract for sale upon an open book account in which the seller has not retained or taken a security interest in the motor vehicle sold or collateral security for the buyer's obligation, the buyer is not required to pay any sum other than the cash price of the motor vehicle sold in connection with the sale or extension of credit, and the

> buyer is obligated to pay for the motor vehicle in full within 90 days after the time the sale or contract for sale was made. These terms also mean and apply to any extension, deferment, renewal, or other revision of an installment sale contract. (Emphasis added.)

Under this section in order for a particular document to be an installment sale contract it must:

1. Be a contract for the retail sale of a motor vehicle, **and**
2. Be payable in part or in full in 2 or more scheduled payments; **or**
3. Be any other form of contract that has a similar purpose or effect.

The transaction proposed by Bank here falls squarely within this definition of installment sale contract. The Bank proposes to effectuate its installment sale contracts through an agency relationship with the automobile dealer. Clearly, national banks have authority to employ agents in the loan making process. 12 CFR 7.1004(a) and (b). However, some individual agents may not be able lawfully to accept such engagements. Agents who by law are prohibited from entering into a particular agency engagement may not bootstrap an unlawful engagement into a lawful one through application of the loan making and agent engagement authority of the bank. To do otherwise would constitute an *ultra vires* act.

Section 19 of the Restatement (Second) of the Law of Agency, states:

> The appointment of an agent to do an act is illegal if an agreement to do such an act or the doing of the act itself would be criminal, tortious, or otherwise opposed to public policy.

Under this rule if the act performed by an agent is unlawful, it remains an unlawful act even if the same act performed by the agent's principal would be lawful. A principal who engages an agent to perform an act lawful if executed by the principal, but violative of public policy when performed by the agent, may in some circumstances forfeit all compensation or benefit from the unlawful acts performed by the agent.

Under the MVSFA it is unlawful for any person to transfer an “installment sale contract” to any other entity not licensed under the Act. Likewise, it is unlawful for “installment sellers” to be engaged as the agent of an unlicensed entity for the purpose of executing “installment sale contracts.” The Commissioner's Declaratory Ruling stated that the proposed National City transaction, when considered in its totality, is the functional equivalent of an installment sale agreement and transfer governed by the MVSFA.

The Declaratory Ruling of the Commissioner is binding. National City Bank failed to seek judicial review of the Declaratory Ruling as provided by Michigan law.

On July 27, 1999, National City Bank requested a Declaratory Ruling from the Michigan Financial Institutions Bureau (now Office of Financial and Insurance Services, Division of Financial Institutions) for an interpretation of the MVSFA. This request for a Declaratory Ruling, attached as Exhibit 2, was made under state law pursuant to the provisions of the Michigan Administrative Procedures Act (hereafter "MAPA"), MCL 24.263; MSA 3.560(163).

Attorney Rodney D. Martin's request, on behalf of National City Bank, stated the following:

> I am writing on behalf of National City Bank to request a declaratory ruling of the Financial Institutions Bureau regarding the applicability of the Michigan Motor Vehicle Sales Finance Act to a direct installment loan made by a bank at the offices of a motor vehicle seller, who serves as the bank's agent in the transaction...
>
> ***
>
> National City Bank respectfully requests a declaratory ruling from the Financial Institutions Bureau that the Bureau would take no action against National City Bank or any motor vehicle dealer in Michigan for engaging in the program as we have described it." (Emphasis added.)

On January 1, 2000, over eleven months ago, the Division of Financial Institutions issued its Declaratory Ruling, stating the following:

> I. AUTHORITY
>
> You have requested on behalf of National City Bank ("National City"), a national banking association, a declaratory ruling regarding the applicability of the Motor Vehicle Sales Finance Act ("Act") to National City's proposed "direct lending program."
>
> Section 63 of the Administrative Procedures Act of 1969 allows an agency to issue a declaratory ruling, upon request by an interested person, as to how a statute administered by the agency would be applied to an actual state of facts. Section 2(17) of the Act defines the administrator of the Act as the"commissioner of the financial institutions bureau." Thus, the Commissioner has authority to issue a declaratory ruling regarding the applicability of the Act to an actual state of facts. Your request letter of July 27, 1999, coupled with your letters of February 17, 1999, and March 8, 1999, set forth a statement of facts sufficient to enable the Bureau to issue a declaratory ruling regarding the applicability of the Act to the stated facts.

Section 63 of MAPA, MCL 24.263; MSA 3.560(163) governs a request for a declaratory ruling by providing the following:

> On request of an interested person, an agency may issue a declaratory ruling as to the applicability to an actual state of facts of a statute administered by the agency or of a rule or order of the agency. . . A declaratory ruling is binding on the agency and the person requesting it unless it is altered or set aside by any court. An agency may not retroactively change a declaratory ruling, but nothing in this subsection prevents an agency from prospectively changing a declaratory ruling. A declaratory ruling is subject to judicial review in the same manner as an agency final decision or order in a contested case. (Emphasis added.)

Thus, Michigan law makes unequivocally clear that 1) a declaratory ruling is binding on the agency and the person requesting it unless it is altered or set aside by any court, and 2) a declaratory ruling is subject to judicial review in the same manner as an agency final decision or order in a contested case.

Judicial remedies pursuant to state law were available to National City Bank but were abandoned.

A person aggrieved by an agency final decision or order may seek judicial review as provided in Chapter 6 of MAPA, MCL 24.301 *et seq*; 3.560(101) *et seq*, and Michigan Court Rules, MCR 7.105 *et seq*. Hence, these judicial review remedies were available to review the Commissioner's declaratory ruling. National City Bank, however, accepted the Commissioner's ruling and did not seek judicial review.

Section 101 of MAPA, MCL 24.301; MSA 3.560(201) provides that:

> When a person has exhausted all administrative remedies available within an agency, and is aggrieved by a final decision or order in a contested case, whether such decision or order is affirmative or negative in form, the decision or order is subject to direct review by the courts as provided by law. Exhaustion of administrative remedies does not require the filing of a motion or application for rehearing or reconsideration unless the agency rules require the filing before judicial review is sought. A preliminary, procedural or intermediate agency action or ruling is not immediately reviewable, except that the court may grant leave for review of such action if review of the agency's final decision or order would not provide an adequate remedy.

Section 102 of MAPA, MCL 24.302; MSA 3.560(202) provides that:

> Judicial review of a final decision or order in a contested case shall be by any applicable special statutory review proceeding in any court specified by statute and in accordance with the general court rules. In the absence or inadequacy thereof, judicial review shall be by a petition for review in accordance with sections 103 to 105.

Judicial review of a declaratory ruling provides for reversal of a final decision upon any of the stated grounds set forth in 106(1) of MAPA, MCL 24.306(1); MSA 3.560(206)(1), which provides that:

> Except when a statute or the constitution provides for a different scope of review, the court shall hold unlawful and set aside a decision or order of an agency if

> substantial rights of the petitioner have been prejudiced because the decision or order is any of the following:
>
> (a) In violation of the constitution or a statute.
>
> (b) In excess of the statutory authority or jurisdiction of the agency.
>
> (c) Made upon unlawful procedure resulting in material prejudice to a party.
>
> (d) Not supported by competent, material and substantial evidence on the whole record.
>
> (e) Arbitrary, capricious or clearly an abuse or unwarranted exercise of discretion.
>
> (f) Affected by other substantial and material error of law.

Section 105 of MAPA, MCL 24.305; MSA 3.560(205), allows for leave to present additional evidence upon an inadequate record made before an agency. Section 104(3) of MAPA, MCL 24.304(3); MSA 3.560(204)(3), sets forth the procedure for alleging irregularity in procedures before an agency. Section 105 of MAPA, MCL 24.305; MSA 3.560(205), provides for timely application to the court for leave to present additional evidence before the agency on such conditions as the court deems proper. This section further provides that "The agency may modify its findings, decision or order because of the additional evidence and shall file with the court the additional evidence and any new findings, decision or order, which shall become part of the record." In addition, National City could also have sought a stay pursuant to MCR 7.105(G), governing stays of enforcement of agency orders. MCR 7.105(I) also addresses an application to present proofs of alleged irregularity in procedure before the agency or to allow the taking of additional evidence before the agency. Section 104(1) of MAPA, MCL 24.304(1); MSA 3.560(204)(91), also provides that: "[T]he agency may grant, or the court may order, a stay upon appropriate terms."

When National City Bank turned to the state for a declaratory ruling on the interpretation and applicability of state law, it submitted to the jurisdiction of the state. Having failed to avail itself of state judicial remedies, it is now bound by the declaratory ruling it sought. The OCC is without authority to supersede or overrule the unchallenged ruling of the state agency on a question of state law, and the national bank is now estopped from seeking such relief

from the OCC.

Conclusion

For all the reasons stated in this Memorandum, I respectfully urge the OCC to take no action that would preempt this valuable state consumer protection act.

Respectfully submitted,

/ss/

Frank M. Fitzgerald, Commissioner
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Lansing, MI 48909

(517) 335-3167

Dated: November 22, 2000